

Internal Revenue Service

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Department of the Treasury

Washington, DC 20224

Third Party Communication: None

Date of Communication: Not Applicable

Person To Contact:

, ID No.

Telephone Number:

Refer Reply To:

CC:ITA:B03

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March 11, 2011

LEGEND

Taxpayer =

Co-conspirator =

A =

B =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Date 5 =

Year 6 =

Location Q =

\$v =

\$x =

\$y =

\$z =

m =

n =

Court =

Dear _____ :

This letter relates to your request for a ruling on behalf of Taxpayer.

RULING REQUESTED

You have requested a ruling that, based on a method comparing the affected volume of commerce in the Plea Agreement to Taxpayer's total gross sales, a portion of the Civil Settlement is not subject to the deduction limitations of section 162(g) of the Internal Revenue Code because a portion of the Civil Settlement payments applies to sales at times, in geographies, and as to sales volumes to which the Taxpayer did not plead guilty in the criminal case and, therefore, these payments are not on account of the criminal proceedings.

FACTS

Taxpayer manufactures and sells A in area B. Taxpayer was investigated by the Department of Justice, Antitrust Division for violations of the Sherman Antitrust Act. Taxpayer entered into a Plea Agreement on Date 1 with the Department of Justice. The Plea Agreement addresses the Taxpayer's violation of the Sherman Antitrust Act, 15 U.S.C. §1, by way of the Taxpayer's agreement with its competitors to allocate customers of A in Location Q (the "Violation"). Location Q is within area B. The Violation concerns the time period of Date 3. A criminal fine of \$z was imposed for the Violation. During Date 3, the Taxpayer's gross sales approximated \$y. The Taxpayer's Plea Agreement and other documents suggest that an amount equal to \$x of these sales was "affected" by the Taxpayer's unlawful conduct. In Year 6, Co-conspirator, another manufacturer of A, also entered into a Plea Agreement which relates to the same conduct in the same limited geographic area.

As a result of the Plea Agreement, nearly one hundred civil actions were filed on behalf of direct purchasers of A (primarily retailers selling A to customers) and indirect purchasers (primarily customers) which have been consolidated into a single civil action pending in the Court. Despite the limited geographic scope of the Taxpayer's Violation,

the plaintiffs in the civil suits alleged that manufacturers of A conspired to allocate customers throughout the United States. At Co-conspirator's criminal sentencing held on Date 5, the Court requested that the attorney for the United States comment on the broader civil allegation. The Assistant United States Attorney overseeing the investigation and prosecution informed the Court that the Violation on which the Plea Agreement was based, which was the only criminal offense found, was not based on a nationwide conspiracy.

The Taxpayer entered into a Civil Settlement with the Direct Purchasers in Date 2 by making a payment of \$v to resolve any/all potential claims of all Direct Purchasers nationwide. The Civil Settlement is based on all of the Taxpayer's sales across Area B through Date 4. Accordingly, the Civil Settlement was derived from a \$y sales volume, rather than the \$x volume of commerce set forth in the Plea Agreement. The Taxpayer entered into the settlement solely for purposes of expediency and without admission of any wrongdoing. Thus, m% of the Taxpayer's gross sales for the period were excluded from the Violation and Fine calculation under the Plea Agreement but were included in the calculations which derived the Civil Settlement payment of \$v.

LAW AND ANALYSIS

Section 162(a) of the Internal Revenue Code provides that all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business are allowed as a deduction.

Section 162(g) provides that if a taxpayer pleads guilty to violating the antitrust laws, no deduction shall be allowed under Section 162(a) for two-thirds of any amount paid or incurred (1) on any judgment for damages entered against the taxpayer under section 4 of the Act entitled "An Act to supplement existing laws against unlawful restraints and monopolies, and for other purposes", approved October 15, 1914 (commonly known as the Clayton Act), on account of such violation or any related violation of the antitrust laws which occurred prior to the date of the final judgment of such conviction, or (2) in settlement of any action brought under such Section 4 on account of such violation or related violation.

Section 1.162-22(f), Example 3, of the Income Tax Regulations shows that section 162(g) does not apply to the portion of a settlement that relates to sales or products that are not the subject of a criminal case. Specifically, the example determines that the limitations of section 162(g) are inapplicable where the criminal case involved the fixing of prices for electrical transformers and the civil case involved price fixing related to electrical insulation for high-tension power poles. In the example, the entire civil settlement amount was deductible and no allocation was necessary because the entire civil case was based on a separate product or product line than that of the criminal proceeding.

In Federal Paper Board Co. v. Commissioner, 90 T.C. 1011, (1988) a taxpayer was indicted for antitrust violations relating to folding cartons. The taxpayer was then sued civilly on the theory that it violated the law in the sale of both folding cartons and milk cartons. The court ruled that the limitation deductions of section 162(g) did not apply to that portion of the civil settlement that related to milk cartons, and accepted the taxpayer's method of determining the deductible portion of the settlement by the ratio of the taxpayer's sales of milk cartons to total sales.

In McDermott, Inc. v Commissioner, 101 T.C. 155 (1993) the taxpayer entered a plea of nolo contendere to antitrust violations and settled subsequent civil suits. The court held that 2/3 of the payments in settlement of the civil suits were not deductible under section 162(g)(2) because the payments were "on account of such violation". The admitted conduct in the criminal proceeding was co-extensive with the conduct at issue in the civil suits and settlements and were thus in settlement of any action brought under such Section 4 on account of such violation.

In this case, the Plea Agreement and other documents establish that the volume of commerce affected by the Taxpayer's unlawful conduct was \$x. The Taxpayer's total volume of sales during the period of Date 3 was \$y. The civil settlement of \$v related to the taxpayer's total volume of sales during the period of Date 3. Therefore, the portion of the civil settlement subject to section 162(g) is x/y multiplied by \$v. Pursuant to section 162(g), 2/3 of that amount is not allowed to be deducted. The remaining amount of the civil settlement is not subject to section 162(g). Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

A copy of this letter must be attached to any income tax return to which it is relevant. Alternatively, taxpayers filing their returns electronically may satisfy this requirement by attaching a statement to their return that provides the date and control number of the letter ruling.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

Sincerely,

Christopher F. Kane
Chief, Branch 3
(Income Tax & Accounting)

cc: